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In the Supreme Court of the United States.

OCTOBER TERM, 1923.

CLALLAM COUNTY, WASHINGTON; William A. Nelson, Sheriff of Clallam County, Washington; E. C. Stewart, Treasurer of Clallam County, Washington, et al.,

v.

THE UNITED STATES OF AMERICA AND the United States Spruce Production Corporation.

No 255.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR THE UNITED STATES.

STATEMENT.

This case comes before this Court upon a certificate from the Circuit Court of Appeals for the Ninth Circuit, presenting two questions:

I. Did the United States District Court have jurisdiction of the suit?

II. Is the property of the Spruce Production Corporation subject to State taxation? (Rec. p. 6.)

The gradual evolution of the activities of the Government in the production of aeroplane material during the war may be traced in the following statutes:

June 3, 1916, 39 Stat. p. 213, c. 134, Sec. 120.
May 12, 1917, 40 Stat. p. 42, c. 12.
June 15, 1917, 40 Stat. p. 187, c. 29.
July 24, 1917, 40 Stat. p. 245, c. 40, Sec. 9.
Oct. 1, 1917, 40 Stat. p. 296, c. 61.
Oct. 6, 1917, 40 Stat. p. 356, c. 79.
May 20, 1918, 40 Stat. p. 556, c. 78.
July 9, 1918, 40 Stat. p. 849, c. 143.
July 9, 1918, 40 Stat. p. 888.

The creation of the United States Spruce Production Corporation, and the employment by it of both military and civilian forces, was one of the final steps in this series of efforts.

In May, 1918, the President, by virtue of the power conferred upon him by the so-called Overman Act (Act of May 20, 1918, c. 78, 40 Stat. 556), created the Bureau of Aircraft Production and a Division of Military Aeronautics, the executive officer of which was the Director of Aircraft Production.

The Act of July 9, 1918, 40 Stat. c. 143, p. 888, provided (Sec. 1): That the Director of Aircraft Production might form, under the laws of the District of Columbia or those of any State, corporations for the production of aircraft, equipment, and materials and for the building and operation of railroads in connection therewith; (Sec. 2) That he might, on behalf of the United States purchase not

less than a majority of the voting stock and all or part of the nonvoting stock, bonds, notes, debentures, or other securities, and with the approval of the Secretary of War might sell the same. provided that the United States should never become a minority holder of voting stock therein; (Sec. 3) That, within one year after the signing of a treaty of peace he should institute proceedings for dissolution; (Sec. 4) That the Secretary of War might assign enlisted men or commissioned officers to carry on the work of such corporations; (Sec. 5) And that the Secretary of War, acting through the Director of Aircraft Production, might transfer to such corporations "any interest of the United States in any existing contracts for aircraft, aircraft equipment, or materials therefor, and the title to any lands, plants, railroads, or equipment used in or in connection with the production of aircraft, aircraft equipment, or materials therefor, on such terms as the Secretary of War, acting through the Director of Aircraft Production shall deem fit."

It was in pursuance to the authority given in this Act that the Director of Aircraft Production, on August 21, 1918, caused the United States Spruce Production Corporation to be incorporated under the laws of the State of Washington. The United States at all times owned all of the capital stock issued, and all of the certificates therefor stood in its name save the shares necessary to qualify the directors. These were issued in the names of the directors who executed assignments to the Secretary of War, endorsed

the certificates in blank and deposited them with the secretary of the corporation (Rec. pp. 2, 3). The United States purchased all of the bonds (Rec. p. 4).

On January 29, 1919, subsequent to the Armistice, the Bureau of Aircraft Production and the Division of Military Aeronautics were consolidated, forming the Air Service, as then provided for by Army regulations, which functioned under the Director of Air Service. This title was later changed to Chief of Air Service. The Air Service, with its powers and duties as provided for by Army regulations, continued until June 4, 1920, on which date the National Defense Act, as amended, became effective. This Act provided for the office of Chief of Air Service. (41 Stat. c. 227 p. 768.)

Army Regulation No. 95–5, November 17, 1921, Paragraph E, as prescribed by the Chief of Air Service, is as follows:

> I will, in accordance with instructions from the Secretary of War, exercise administrative supervision over the liquidation of the Bureau of Aircraft Production and the United States Spruce Production Corporation.

Other relevant facts concerning the creation and activities of the Spruce Production Corporation are contained in the certificate from the Circuit Court of Appeals. (Rec. pp. 2–6.)

ARGUMENT.

I.

First Certified Question.

Did the United States district court have jurisdiction of the suit?

The jurisdiction of the United States District Court to entertain this suit rests upon two grounds: (A) That the suit has been brought by the United States, and (B) That it arises under the Constitution of the United States.

A.

The suit has been brought by the United States.

The United States has instituted this suit, not merely for the purpose of giving a Federal court jurisdiction, but to assert its right as a sovereign and to claim for its property and for one of its legally constituted agencies immunity from taxation by a State. It is a proper, if not necessary, party plaintiff, (*a*) because of its pecuniary interest (*Dugan* v. *United States*, 3 Wheat. 172, 180; *Cotton* v. *United States*, 11 How. 228, 231), and (*b*) because of its public duty to keep and maintain its property and the exercise of its sovereign powers free and untrammeled. (*In re Debs*,, 158 U. S. 564, 584; *United States* v *Rickert*, 188 U. S. 432, 444.)

The rule that a stockholder's remedy is through an action by the corporation, if it be willing to sue, has no application to the case at bar, for the reasons upon which it is founded do not exist under the circumstances of this case. *Cessante ratione legis cessat et ipsa lex.*

B.

The suit arises under the Constitution of the United States.

This suit must be finally determined upon the merits by deciding whether the limitation upon the taxing power of a State, which is implied in the constitutional provision that "This Constitution, and the laws of the United States which shall be made in pursuance thereof * * * shall be the supreme law of the land" (Constitution, Article VI, Clause 2), shall be so construed as to relieve from State taxation the property of the United States Spruce Production Corporation. Clearly it is a case arising under the Constitution. A Federal question is involved whenever it appears that some right, privilege, or immunity on which recovery depends, will be defeated by one construction of the Constitution or sustained by the opposite construction. (*Starin* v. *New York*, 115 U. S. 248, 257; *Cohens* v. *Virginia*, 6 Wheat. 264, 379; *Jetton v. University of the South*, 208 U. S. 489.)

II.

Second Certified Question.

Is the property of the United States Spruce Production Corporation subject to State taxation?

For more than a century since the decision by this Court of the celebrated case of *McCulloch* v. *Maryland*, 4 Wheat. 316 (1819), it has been conceded that "the States have no power, by taxation or otherwise, to retard, impede, burden, or in any

manner control the operation of the constitutional laws enacted by Congress to carry into execution the powers vested in the Federal Government." No tax imposed by any State can be sustained if its effect be to impose a burden, howsoever light, upon the activities or operations of the United States.

Inasmuch as the determination of the issue now before the Court will depend upon the proper application of the fundamental principles laid down in that case, it may be pardonable to note precisely what was involved and what was decided in that case.

McCulloch v. *Maryland*, 4 Wheat. 316 (1819) involved a statute of Maryland which provided that it should not be lawful for any bank engaged in business within the State but not incorporated under its laws to issue notes excepting in certain denominations and upon stamped paper to be purchased from the State, unless such bank should pay annually, in advance, for the use of the State, the sum of $15,000. Penalties for failure to comply with the provisions of this act were sought to be recovered from the Second Bank of the United States, a corporation which was organized under an act of Congress to do a general banking business, and had established a branch at Baltimore.

Two questions were involved—(1) whether the incorporation of the bank was within the powers vested by the Constitution in the Federal Government, and (2) whether the State law was valid.

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The first of these questions is not of interest here, for it is conceded that the provisions of the Act of Congress, in pursuance of which the United States Spruce Production Corporation was incorporated as a means for prosecuting a great war, were clearly within the powers of the Federal Government. Upon the second question, which is material to the present inquiry, this Court held that the statute of Maryland was not valid.

The distinguished Chief Justice who delivered the opinion found no express provision in the Constitution granting to the Bank immunity from State taxation, nor any express limitation upon the taxing power of the State which checked its hand. On the contrary, he recognized the taxing power as one of the incidents of sovereignty, which the States had in nowise surrendered upon the formation of the Union. The decision rested upon the implied limitation of the scope of the State's taxing power, which arose out of the relations created by the Constitution between the United States and the several States. "This Constitution and the laws of the United States which shall be made in pursuance thereof * * * shall be the supreme law of the land." The Constitution and the laws of the United States can not be supreme unless their operation be absolutely free from and unfettered by the enactments of any State.

From this basic proposition four conclusions followed. These Chief Justice Marshall himself stated in a later case, *Weston* v. *City Council of Charleston*, 2 Pet., 449, 467, in the following words:

(1) That all subjects over which the sovereign power of a State extends are objects of taxation; but those over which it does not extend are, upon the soundest principles, exempt from taxation.

(2) That the sovereignty of a State extends to everything which exists by its own authority or is introduced by its permission; but not to those means which are employed by Congress to carry into execution powers conferred on that body by the people of the United States.

(3) That the attempt to use the power of taxation on the means employed by the Government of the Union in pursuance of the Constitution, is itself an abuse, because it is the usurpation of a power which the people of a single State can not give.

(4) That the States have no power, by taxation, or otherwise, to retard, impede, burden, or in any manner control the operation of the constitutional laws enacted by Congress to carry into execution the powers vested in the General Government.

Applying these principles to the case then before it this Court held that, as the Bank was a means or instrumentality employed by the United States to carry out its constitutional powers, a regulation and tax, such as Maryland had imposed upon its operations was unconstitutional and void.

The obvious and imperative necessity for complete freedom of the sovereign powers of the United States from control or interference by any State, stands out clear as the basis of decision of this great

constitutional landmark. A half century later, in *Railroad* v. *Peniston*, 18 Wall., 5 (1873), it is again declared by Mr. Justice Strong (p. 36):

> It is, therefore, manifest that exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents or upon the mode of their constitution, or upon the fact that they are agents, but *upon the effect of the tax;* that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power. (Italics ours.)

This is the criterion by which must be determined the validity of any State tax which is questioned on this ground.

The principle of "noninterference" announced in *McCulloch* v. *Maryland*, *supra*, may be applied to Federal agencies or instrumentalities of many different kinds. Among the cases which have called for the application of the principle by this Court, the instant case is unique.

In one of the cases, which involved the right of a State to tax the property of a railroad company, Mr. Justice Chase said (*Thomson* v. *Pacific Railroad* 9 Wall., 579, 591):

> But we think there is a clear distinction between the means employed by the government and the property of the agents employed by the government. Taxation of the agency is taxation of the means; taxation of the property of the agent is not always, or generally, taxation of the means.

From this language the Appellants have drawn the conclusion that State taxation of the right of a Federal agency *to be, to operate,* and *to function,* is impliedly forbidden by the Constitution; but that taxation of the *property* of such agent is *never* so forbidden. (Brief for Appellants, pp. 27, 29, 33, 37, 40, and 42.) It is to be noted that this is precisely what Mr. Justice Chase carefully avoided saying. They vary the language of the last line quoted, from "taxation of the property of the agency is *not always* or *generally* taxation of the means," to "taxation of the property of the agency is *never* taxation of the means." The Court clearly recognized that in some cases taxation of the property of the agency may amount to *taxation of the means.* It is not *always* so. Nor is it *generally* so. However, agencies such as the Spruce Production Corporation are unusual, and bear an unusual relation to the Federal Government; and the Court clearly recognized the possibility of the creation of such an agency.

We are quite willing to concede that in all the cases cited in the Appellant's brief, save one (*Owensboro National Bank* v. *Owensboro,* 173 U. S. 664), this Court has said that taxation of the property of the agencies or instrumentalities there involved did not amount to an interference with the operations, functions, and activities of the Federal Government. But we can not admit that taxation of the property of the Spruce Production Corporation is not such an interference.

We believe the property of the United States Spruce Production Corporation is exempt from State taxation for two reasons:

A. The Corporation is of such character that taxation of its property is in fact taxation of a means or instrumentality of the Federal Government and imposes a burden upon the United States.

B. The property of the corporation is in fact the property of the United States.

A.

The United States Spruce Production Corporation is of such a character that taxation of its property is in fact taxation of a means or instrumentality of the Federal Government and imposes a burden upon the United States.

The Government of the United States in the exercise of the extensive powers vested in it, acts in a variety of ways and employs means, agencies, and instrumentalities of varying character.

It has officers, boards, and commissions whose relations with, and responsibilities to, it are most intimate and direct. Their activities are the activities of the Government and any restraint upon or regulation of them is a direct interference with the exercise of Federal powers. It is held that a State is without power to impose a tax upon their occupations or upon the emoluments of their offices because in agencies of this character such tax would impose a burden upon their ability to serve the Federal Government. As to property, real or personal, that which belongs to them personally is clearly subject to the taxing power of the State; but that which is com-

mitted to their custody or control by the United States and which is used in the performance of services to it is exempt from taxation. To tax it would impose a burden upon the Federal Government.

The United States, in the exercise of its powers, may create corporations. In such cases the granting of the corporate franchise is a Federal power. The United States is vitally interested in the right or franchise of these bodies to be corporations and to exercise their charter powers. A tax upon their franchise or their right to do business would be an interference with the power to create them. For, as Chief Justice Marshall said, "The power to destroy (to tax) may defeat and render useless the power to create." Regardless of whether such corporations, when formed, perform any services for the Government or not, it is interested in their existence and operation in the economic and industrial life of the people. A State can not tax their franchises or operations. Beyond this, however, the Federal Government is not bound, nor does it desire to exercise its power to give any undue preference to them. They engage in private or quasi-public business and they take their chance of survival with the individuals and corporations operating under franchises granted by the several States. They must bear the taxes upon their property in common with other business entities. The mere fact that they hold a Federal franchise does not exempt their property from taxation, for taxation of their property does not infringe upon the exercise of any Federal power.

The United States, in the exercise of its powers, may also grant franchises to corporations which have been created by the several States. These Federal franchises are exempt from taxation for the same reasons which we have already observed. The Federal power to grant them may not be interfered with by a State. Property of these corporations, however, is subject to taxation. That does not retard or impede any Federal function.

The United States may also enter into contracts with corporations created by it or by the States for the transaction by them of some Government business—to transport the mails, to haul Government property, to transmit and deliver Government messages, or to furnish to the Government material or supplies. It matters not whether such contracts were entered into at the time of their incorporation or afterwards, or whether the consideration given by the Government was a grant of land, the grant of a franchise, or a money payment. The relation with the Government is purely contractual and the immunity of such corporation from State taxation goes only so far as is necessary to keep such contract free and clear of any encumbrance or interference by the State. The actual business transacted under such contracts is Government business and the States can not by taxation or otherwise interfere with it. But the exemption does not extend to the business which the corporation transacts in its private capacity nor to the property which it employs.

When the United States thus enters into a contract with an independent contractor which is engaged in an independent business for its own profit, the Government exercises no supervision or control over it other than that stipulated in the contract. The United States is concerned only with the execution of the contract, a thing which the contractor has engaged to perform, notwithstanding its liability to State taxes or any other burdens or demands upon it. With the property of such contractor the Government is not concerned nor is any tax upon such property a burden upon it or an interference with the exercise of its powers.

Immunity from State taxation, in all of these cases, extends so far, and only so far, as is necessary to preserve the exercise of Federal powers free from control or encumbrance by the State; and the exemption of Federal agencies does not depend "upon the mode of their constitution * * * but upon the effect of the tax." (*Railroad Company* v. *Peniston*, 18 Wall. 5, 36.)

In the land-grant-railroad and the post-road-telegraph cases, relied upon by the Appellants, the agencies involved were of the kind which we have just described. The claim for immunity in each case was based upon one or both of two grounds—either that the corporation held a Federal franchise or that it had a contract under which it was doing some business for the Government. In each case it was held that the Federal franchise and business

could not be taxed, but, as each of these corporations was extensively engaged in private business, it was quite properly held that their property was not exempt. Those decisions are authority for the proposition, that in the case of agencies which are primarily private enterprises holding Federal franchises or having contractual relations with the United States, the taxation of their property is not a burden upon the exercise of the powers of the Federal Government. They do not hold that State taxation of the property of agencies such as the Spruce Production Corporation is valid.

The problem in any given case can not be solved merely by determining in the first instance whether the agency in question has a connection with the Federal Government, and then applying, with Procrustean rigidity, the rule that its functions are exempt from, and its property is subject to, taxation by a State. In each case, regard must be had to the Federal authority under which the agency is created or is functioning, to the nature of the agency and its relations to the Government, to its purposes and the character of its operations, and to the origin, nature, and use of its property. It is only from a consideration of all these matters that it can be determined whether the taxation of the property of the agency imposes a burden upon, or interferes with the free use of, powers of the Federal Government.

The United States Spruce Production Corporation was created in pursuance to the provisions of the

Act of Congress of July 9, 1918, 40 Stat. 888, c. 143, by four civilians and three Army officers, who, at the instance of the Director of Aircraft Production of the United States, prepared, executed, and acknowledged the articles of incorporation. (Rec. p. 2.) In so doing these incorporators were not acting as individuals, but were agents of the United States. They conformed to the laws of the State of Washington, obtained a charter from that State, and in the technical sense the corporation is a corporation of the State of Washington. But to say that it is a corporation of the same character as any other private corporation formed under the laws of Washington and having contractual relations with the Federal Government, is to lose sight entirely of its genesis and *raison d'être*. A corporation bearing the same relation to the United States as this corporation could not come into being without the enabling legislation of Congress.

As to its powers and the scope of its activities, they were limited—not by the laws of Washington, but by the Federal laws—to the production of aircraft materials and such operations as were incident thereto. Its purpose was to serve the needs of the Nation in a great war, and not to exercise in the field of private industry and commerce the charter powers which the State of Washington gave it. Its "activities were wholly directed to the Government's program of production of aeroplane lumber." (Rec. p. 3.)

As to its property, it was all acquired by funds derived from the United States. (Rec. p. 6.) Some of the property belonged to the United States before the corporation was formed. This was transferred to it for $274,164.76 and the assumption of outstanding obligations of the United States incurred in connection with the property. (Rec. p. 3.) Every dollar subscribed and paid in upon the stock was paid by the United States, and all bonds sold by the corporation were sold to the United States. (Rec. pp. 3–4.) In fact the character of the company was such and the provisions of its bonds were such that neither stock nor bonds could have been sold in the investment market. The payments made by the United States for stock and bonds and the payment of $274,164.76 by the corporation were merely methods of bookkeeping.

The life of the corporation was limited by Act of Congress (July 9, 1918, 40 Stat. 889, c. 143, Sec. 3) to the duration of the war and such time thereafter as might be necessary for the purpose of liquidation. The corporation is engaged to-day solely in liquidation. (Rec. p. 4.)

These facts make it clear that this corporation is not within any of the classes which have heretofore been dealt with by this Court in the cases cited by the Appellants.

It was not incorporated by the Act of Congress as a national bank, nor did it hold a franchise from the Federal Government as the railroad and telegraph companies referred to; but it was incorporated in

pursuance to Federal laws, exclusively to serve the national needs; its purposes and activities were limited by the Government; its operations entirely controlled by the United States; its life determined by the duration of the national emergency; it was subsidized, supported, and maintained by the United States and all profits and losses resulting from its operations inured to or were borne by the United States. It seems idle to say that a tax upon the property of such a corporation is not a tax upon the activities of the United States or a burden upon the exercise of its constitutional powers.

By whom would such a tax be paid? By the corporation in the first instance, but out of moneys provided by the United States. And the effect of such tax would be either to reduce by the amount of the tax the effective scope of the activities of the corporation, or to call upon the Treasury of the United States to make payment. It could not pay the tax out of its earnings in the conduct of a private business, for it conducted none; nor could it pay out of the sale of capital assets unless it converted to that purpose property already dedicated to the purposes of the Federal Government.

If such a corporation be compelled to retrench, what activities will be curtailed or what business be suspended? Obviously, the activities and the business of the United States.

In the case of such a corporation, taxation of its property is taxation of a means, agency, or instrumentality of the Federal Government, and does

impede the free exercise of Federal powers. The distinction is between a corporation which is *exclusively* and one which is *incidentally* an agency of the Government.

In *Owensboro National Bank* v. *Owensboro*, 173 U. S. 664, it was held that a State tax upon the intangible property of a national bank was not valid. This decision, following *Thomson* v. *Pacific Railroad*, 9 Wall. 579, and *Railroad Company* v. *Peniston*, 18 Wall. 5, recognizes a difference between national banks, which are in themselves governmental instrumentalities, and railroads which are primarily private enterprises performing *inter alia* Federal services (*Willoughby on the Constitution* (1910), Vol. 1, Sec. 46, pp. 97–98).

As we have already observed, we know of no case which has come before this Court involving a State tax upon the property of an agency such as the Spruce Production Corporation. Several cases have arisen in the courts below, however, and the unanimous opinion of these courts is that such taxation is not valid.

United States v. *Coghlan*, 261 Fed. 425 (District Court of Maryland, Rose, J., Nov. 3, 1919).

King County v. *U. S. Shipping Board Emergency Fleet Corporation*, 282 Fed. 950 (Circuit Court of Appeals, Ninth Circuit, Sept. 5, 1922).

United States Spruce Production Corp. v. *Lincoln County*, 285 Fed. 388 (District Court of Oregon, Dec. 18, 1922).

United States et al v. *Clallam Co.*, 283 Fed. 645 (District Court, Western District of Washington).

These cases are in no wise distinguishable from the case at bar, and the reasoning of the opinions filed fully sustains our present contention. It clearly recognizes that there is a difference in the character of agencies or instrumentalities employed by the Federal Government in the exercise of its constitutional powers; that while it may be true that in the case of an agency not wholly and completely dedicated to the service of the Government a tax upon its property will not interfere with the operations of the Government, nevertheless in the case of a corporation such as the United States Spruce Production Corporation, a tax upon its property is a tax upon the means or instrumentality employed by the Government and is not valid.

The question here is quite different from that decided in *United States* v. *Strang*, 254 U. S. 491, and *Sloan Shipyards* v. *U. S. Fleet Corporation*, 258 U. S. 549. Those cases involved the question whether the Fleet Corporation partook of the sovereignty of the United States to such extent that it possessed that immunity from suit which inheres in the sovereign. Here the question is whether the taxation of the property of the corporation by a State will impose a burden upon the operations of the Federal Government. It would not be contended for a moment that a national bank or a Federal Land Bank is immune from suit, yet it has been held that the franchises of a national bank (*McCulloch* v. *Maryland*, 4 Wheat., 316; *Osborn* v. *United States Bank*, 9 Wheat., 738) and

the essential operations of a Federal Land Bank (*Federal Land Bank of New Orleans* v. *Crossland*, 261 U. S. 374) were immune from taxation by a State.

The Appellants lay great store by the fact (Brief, pp. 26–46) that in the Act providing for the formation of corporations such as the Spruce Production Corporation Congress has not expressly declared that the corporate property shall be free of State taxation. Such declaration, however, is not necessary. There was none in *McCulloch* v. *Maryland*, *Osborn* v. *United States Bank*, *supra*, and other cases which might be cited. The exemption does not depend upon the action or declaration of Congress, but upon the essential necessity of maintaining the operations of the United States free from interference by the States. It is true Congress may waive the immunity, as it has done in the case of real property and shares of stock in national banks. (R. S. §5219.) But it is clear that Congress can not, by its declaration, remove from the taxing power of the States any legitimate subject of State taxation. An express exemption contained in the Act of Congress of July 9, 1918, 40 Stat. 888, c. 143, would stand upon the same footing as those incorporated in the Acts providing for the admission of the several States of the Union and in the Constitutions of the several States. Practically every such Act passed since the admission of Louisiana in 1812, has provided that all real and personal property of the United States shall be exempt from taxation by the State. "Such a provision * * * is not

the foundation of the exemption, but is inserted only from abundant caution, and because the assessment of taxes is to be made by local officers skilled in the valuation of property, but presumably unlearned in legal distinctions." *Van Brocklin* v. *Tennessee*, 117 U. S. 151, 171. So also a declaration of exemption in this case would add nothing, nor does its absence detract.

In considering the attitude of Congress toward corporations of the kind here involved, it is worthy of note that Section 35 of the Criminal Code, as amended Oct. 23, 1918, c. 194, 40 Stat. 1015, now includes "any corporation in which the United States of America is a stockholder." The crimes designated in this section, when committed against such a corporation, are made punishable as crimes against the United States. *United States* v. *Bowman*, 260 U. S. 94.

B.

The property of the Spruce Production Corporation is in fact the property of the United States.

Although it clearly followed from the reasoning of this Court in *McCulloch* v. *Maryland*, *supra*, the principle that property belonging to the United States is not taxable by the States in which it is situated did not receive final judicial affirmation until 1885, in *Van Brocklin* v. *Tennessee*, 117 U. S. 151. The Court there took occasion to make an exhaustive review of the cases touching upon the principle, and in so doing cited with approval several which dealt with the

nature and extent of the interest of the United States in property which is sufficient to remove it from the taxing power of the States (pp. 168–169).

These and later cases make it clear that whether property be exempt from State taxation does not depend upon who holds the legal title nor upon who, in strict technical sense, holds the equitable title, but upon who in fact is the owner for whose benefit the property is held.

Thus where Congress has prescribed the conditions upon which portions of the public domain may be alienated, and these conditions have been met by a prospective vendee but no patent has been issued by the United States, the lands become taxable by the State as the property of the vendee, notwithstanding the legal title remains in the United States.

> *Carroll* v. *Safford*, 3 How. 441.
> *Witherspoon* v. *Duncan*, 4 Wall., 210.
> *Wisconsin Railroad Co.* v. *Price County*, 133 U. S. 496.

And of the lands held in trust for the United States the rule is the same. In *Tucker* v. *Ferguson*, 22 Wallace, 527, in which it was decided that public lands in Michigan, granted by Act of Congress to the State to be held by the State to aid in the construction of a railroad, could not be taxed by the State, Mr. Justice Swayne, delivering judgment, said (p. 572):

> Upon general principles she could not tax the land while the title remained in the United States, nor while she held them as

the trustee of the United States, which, in the view of the law, was the same thing.

But, the Appellants insist, there is no trust involved in the case at bar. (Brief, pp. 46–64.) Extensive research has been made by counsel in an endeavor to prove that the relationship between the Spruce Production Corporation and the United States did not create any trust recognized in law or equity. Whether this be true or not, is not, in our opinion, material to inquire. This Court is not so bound by the form of this transaction that it must be blind to its substance. It is no more obliged to close its eyes to the beneficial interest of the United States in this property than it is to treat as a franchise tax a tax which is essentially a property tax, or to treat as a property tax one which is upon the right of succession.

The corporate form is in this case merely a device by which the United States acquired and held title. It is similar to the situation presented in one of the leading tax cases decided in recent years by the Supreme Court of Pennsylvania. *Commonwealth* v. *Westinghouse Airbrake Co.*, 251 Pa. 12. The Westinghouse Company, for the purpose of conducting its business in Wisconsin and in Canada, had organized corporations under the laws of those jurisdictions and held all of their stock and bonds. It contended that no tax should be paid upon the shares of stock which it held in them for the reason that such shares were merely a means or device by which

it held title to their property, which was located outside the State and beyond its taxing jurisdiction. The contention was sustained. Mr. Justice Elkin said (p. 16):

> The creation of a corporation in Wisconsin and the formation of a limited company in Canada were but a means to an end. It became necessary to do these things in order that the business of the defendant company could be advantageously conducted at those places. To all intent and purposes the defendant company owns these plants just as securely as if the legal title was vested in it. The law regards the substance and not the form, and this is especially true in the construction and administration of taxing statutes: *Western Union Telegraph Co.* v. *Kansas*, 216 U. S. 1. As applied to the facts relating to the Wisconsin and Canadian properties we fully concur in the views expressed by the learned court below. We base our conclusion, as did that court, upon the facts relating to the ownership of these plants.

In principle this case is not unlike those cases in the State courts where, for convenience, a State has created corporate bodies to hold property for and manage public educational and charitable institutions and other governmental projects, and attempts have been made to tax property so held. *Auditor General* v. *Regents*, 83 Mich. 467, 47 N. W. 440, 10 L. R. A. 376; *Tulane* v. *Board*, 38 La. Ann. 296; *Board of Trustees* v. *Champaign County*, 76 Ill. 184;

Reclamation Dist. v. *Sacramento County*, 134 Cal. 477, 66 Pac. 668.

It is true that neither the legal nor equitable title to corporate property is in the stockholders, but it is equally true that the stockholders have a beneficial interest in the property which, in proper cases, is recognized and dealt with by the law.

1 Fletcher Cyc. of Corporations, p. 65.
Frick v. *Webb*, 281 Fed. 407.
Ballaine v. *Alaska Northern Ry. Co.*, 259 Fed. 183.

In a variety of cases it has been held that where the legal fiction of the corporate person stands in the way of substantial justice it will be disregarded.

1 Fletcher Cyc. of Corporations, p. 55.
Chicago, Milwaukee & St. Paul Ry. Co. v. *Minneapolis Civic Assn.*, 247 U. S. 490.
Linn & Lane Lumber Co. v. *United States*, 236 U. S. 574.
McCaskill v. *United States*, 216 U. S. 504, 514.
Cleveland-Cliffs Iron Co. v. *Arctic Iron Co.*, 261 Fed. 15.
United States v. *Beebe*, 127 U. S. 338.

And where this interest is united in a single stockholder, which entirely controls the property and assets of the corporation, the stockholder may be treated as the owner of the corporate property. This identity of ownership is frequently recognized, as the Appellants have pointed out (Brief, pp. 53–54) in cases of fraud, but it is by no means confined to such cases. "The legal fiction of distinct corporate

existence may also be disregarded in a case where a corporation is so organized and controlled, and its affairs are so conducted, as to make it merely an instrumentality, conduit or adjunct of another corporation;" and it is necessary to pierce the veil of corporate existence to do substantial justice. *1 Fletcher Cyclopædia of Corporations*, § 45, p. 63; *Hunter* v. *Baker Motor Vehicle Co.*, 225 Fed. 1006; *Westinghouse Electric. & Mfg. Co.* v. *Allis-Chalmers Co.*, 176 Fed. 362; *Interstate Tel. Co.* v. *Baltimore & O. Tel. Co.*, 51 Fed. 49, aff'd in 54 Fed. 50.

In the case of *United States Grain Corporation* v. *Phillips*, 261 U. S. 106, 113, this Court said: "We must look not at the legal title only but at the facts beneath forms"; and it recognized gold bullion shipped by the Grain Corporation as in substance the property of the United States.

The instant case is one in which the legal forms must be laid aside, and the United States, as the sole stock and bond holder, must be recognized as the owner of the corporate property. When this is done, it is clear that the tax complained against is not valid.

CONCLUSION.

The first question certified—"Did the United States District Court have jurisdiction of the suit?"—should be answered in the affirmative for the reason that (A) the suit has been brought by the United States, and (B) the suit arises under the Constitution of the United States.

The second question—"Is the property held by the Spruce Production Corporation under the above statement of facts subject to State taxation?"—should be answered in the negative, for the reason that (A) the corporation is of such character that taxation of its property is in fact taxation of a means or instrumentality of the Federal Government and imposes a burden upon the United States, and (B) the property of the corporation is in fact the property of the United States.

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SEPTEMBER, 1923.

○ Over

ADDENDUM.

The argument presented herein to sustain immunity of property of the United States Spruce Production Corporation from State taxation, is very strongly supported by the opinion of this court in a case decided since the filing of this brief. (*United States* v. *Leroy W. Walter*, No. 20, October Term, 1923. Opinion delivered by Mr. Justice Holmes, Oct. 22, 1923.)

Congress, recognizing the peculiar interest of the United States in the property of corporations created to serve as governmental instrumentalities in the prosecution of the war, extended the provisions of Section 35 of the Criminal Code so as to punish frauds upon "any corporation in which the United States is a stockholder." (Act of October 23, 1918, c. 194, 40 Stat. 1015.) In the *Walter case*, the defendant was indicted upon three counts; the first two for a violation of this act by a conspiracy to make, present for payment, and obtain payment of a fraudulent claim against a corporation of which the United States owned all the stock. The third, which was based upon the same facts, charged a conspiracy to defraud the United States, in violation of Section 37 of the Criminal Code. All three counts were sustained.

In discussing (in connection with the first two counts) the power of the United States to penalize a fraud upon the corporation, the court said:

> The United States can protect its property by criminal laws, and its constitutional power would not be affected if it saw fit to create a corporation of its own for purposes of the Government, under laws emanating directly or indirectly from itself, and turned the property over to its creature. The creator would not be subordinated to its own machinery.

And as the power of the Government to protect its property by criminal laws is not affected merely because it chooses to hold and use that property through the medium of a corporate form, so also the constitutional immunity from State taxation is not affected.

But the court went further. In sustaining the third count it held that a fraud upon the corporation was a fraud against the United States. Upon this point it was said:

> While it is true that the corporation is not the United States (*United States* v. *Strang*, 254 U. S. 491), the contemplated fraud upon the corporation if successful would have resulted directly in a pecuniary loss to the United States, and even more immediately would have impaired the efficiency of its very important instrument.

In like manner, a State tax imposed upon such a corporation would result directly in pecuniary loss to the United States and would impair the efficiency

of a very important governmental instrument. As the fraud charged in the *Walter case* was a fraud against the United States, so the tax here laid is a tax upon the property of the United States. It is accordingly unconstitutional and void.

Respectfully submitted.

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